- Contract based pricing
- Promotional Pricing Plans
- New services outside of price caps

b) Effective Competition Category

The Effective Competition Category identifies those markets in which competition is operating at levels sufficient to provide the price discipline needed to justify replacing price regulation.

The following components are associated with the Effective Competition Category of SWBT's plan:

- **Market trigger:** exchange of local minutes measured for purposes of applying reciprocal compensation arrangements
- **Market area:** the geographic area over which a minute-of-use is considered local for purposes of applying a reciprocal compensation arrangement
- Pricing flexibilities include:
  - All "Open Market Category" flexibilities
  - Access services removed from price caps
  - One day notice period on tariff filings
  - No cost support requirements

c) Deregulation.

Section 10(a) of the 1996 Act specifies the Commission may forbear from applying any regulation or provision of the 1996 Act to a telecommunications carrier or its services in all or some of its geographic areas. The criteria that must be satisfied is also located in Section 10(a). Carriers may petition for forbearance as described in Section 10(c). Existing facilities-based competitive presence, customer willingness to use competitive carrier services, as well as unlimited supply

availability provided in conjunction with the requirements of Section 251, are examples of market indicators that can be used to provide positive proof that the criteria of Section 10(a) have been met.

SWBT believes the following services are already subject to the level of competition necessary to justify their removal from tariff regulation. SBC includes by reference its comments in the Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1. These comments provide information on the number and scope of alternate service providers operating in SWBT's serving areas.

- Special access
- Dedicated transport to end offices and tandems
- Directory assistance and operator services
- Interexchange services[28]

Appendix 4 provides the support required by Section 10(a).

C. INTERSTATE INFORMATION SERVICES SHOULD BE SUBJECT TO ACCESS CHARGES.

The existing enhanced service provider ("ESP") exemption permits ESPs to use local exchange services in lieu of interstate access services. SWBT proposes to eliminate the exemption and replace it with a modified access charge structure. This modified access structure would recognize that Information Service Providers (ISPs) use the network like carriers to provide their services and that access charges should apply for that use. However, the modified access structure would not apply public policy elements to those services that meet the "information service" definition contained in Section 3 of the 1996 Act. This aspect of the modified structure would provide a public interest safety net for the potential rate impact on the continued growth and development of information services. The modified access structure also includes pricing

[28]Carriers should be allowed to continue to file tariffs for interexchange services as advocated in SBC's Comments filed January 28, 1997, in AT&T's Petition for Reconsideration in CC Docket No. 96-61.

flexibilities to incent carriers to deploy advanced technology solutions and to encourage ISPs to migrate to these more efficient technology solutions. SWBT proposes the following modified access structure:

- The current ESP exemption would be eliminated.
- Services that meet the information service definition contained in Section 3 of the 1996 Act would qualify for the modified access structure.
- Local exchange service arrangements provided over the circuit switched network would be replaced with switched access services. The types of pricing flexibility available to a LEC would depend on whether the ISP's switched access service is located in an "Open Market Category" or in an "Effective Competition Category."
- Service arrangements using advanced technology such as frame relay, packet switching, cell relay, ATM, etc., would be treated as new access services and established outside of price caps with "Effective Competition Category" pricing flexibilities.
- Public policy elements would not apply.

III. SWBT'S PLAN ADDRESSES COMPETITIVE REALITY.[29]

A. THE COMMISSION'S PROPOSED ACCESS STRUCTURE MISSES THE MARK.

In the NPRM, the Commission suggested two possible approaches to manage the transition to competitive access pricing: (1) a market-based approach, and (2) a prescriptive approach. With either approach, the Commission's ultimate goal is the same: "adoption of revisions to our access charge rules that will foster competition for these services and enable marketplace forces to eliminate the need for price regulation of these services."[30] Neither approach, as presented, recognizes the urgency of access reform nor provides incumbent LECs with sufficient flexibility to

[29]This section addresses NPRM Sections III.A.; IV.B.; V.B., C; VI. C.
[30]NPRM, para. 14.

compete with telecommunications carriers that can offer directly substitutable unbundled network elements at prices based on forward-looking cost as an alternative to the ILECs' access product.

1. Market-Based Approach

Under the market-based approach,[31] the Commission proposed that regulation of incumbent LECs be relaxed on a service-by-service, market-by-market basis in conjunction with meeting certain market "triggers." The Commission would gradually deregulate access services as the incumbent LEC moves access services from a "baseline" stage of regulation to "potential," "actual," and "substantial" competition stages. The Commission's four stages (baseline, potential competition, actual competition, and substantial competition) to its market-based approach delay meaningful pricing freedoms that are already justified and requires a competitive showing that proposes to rely upon its interpretation of the Section 251(c) requirements set forth in the Interconnection Order. These requirements may not be relevant since the states are responsible for implementing Section 251 of the 1996 Act.

Through the Interconnection Order's prescription of TELRIC-based rates for unbundled network elements,[32] the Commission has presented a direct substitute for incumbent LEC interstate and intrastate switched service, which, if based on Commission "proxies," **would literally give access service away for free**. The Commission tentatively concluded that "when using unbundled network elements to originate and terminate interstate calls, requesting carriers should not be required to pay Part 69 access charges corresponding to those elements."[33] In addition to the obvious price advantage of TELRIC-based unbundled element prices as envisioned by the Commission, the availability of unbundled elements creates a competitive alternative to incumbent

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[31]NPRM, paras. 55-139.
[32]*See*, Note 11, supra.
[33]NPRM, para. 54.

LEC access services that: (1) provides an immediately and ubiquitously available vehicle for competitors to capture the highest revenue generating customers; (2) does not require any capital investment; and (3) does not require additional costs to hire, train, and support personnel. Incumbent LECs do not have the luxury of methodically, over an extended period of time, meeting all of the triggers of the Commission's proposed market-based approach. Direct substitutability of unbundled elements for ILEC access services constitutes imminent "potential," "actual," and "substantial" competition all at once.

The Commission's proposal gets the sequence of actions wrong. The Commission must first allow incumbent LECs to relieve access rates of the support burden and designed inefficiencies through cost causative rebalancing. Only with support-free access rates will incumbent LECs be encouraged to pursue the market triggers and subsequent pricing flexibilities such as volume-term arrangements, deaveraging, and customer-specific pricing. Incumbent LECs already face the untenable task of competing with rebundlers that can purchase cost-based unbundled elements with, for example, no term or volume commitments and with no competitive showing. What possible sense does it make that incumbent LECs must continue to wait upon further demonstration of an open market before they can obtain the same basic pricing flexibilities that rebundlers possess? SWBT has long been requesting the same types of pricing flexibilities offered only now in the Commission's market-based approach.[34] As SWBT describes in Section II above, a more appropriate market-based approach would offer pricing flexibilities such as deaveraging, volume-

[34]*See* SWBT's Comments (filed 11/1/93) and Reply (filed 11/16/93) in RM-8356 (USTA's Petition for Rulemaking on Access Reform). Also, *see* SWBT's Comments in response to the FCC Staff paper on Interstate Access Charge Reform (filed 9/23/93). And, *see* SWBT's Comments in CC Docket No. 90-11 (AT&T's Tariff No. 15 Filing), filed 5/21/92.

term, and contract pricing, only after support-free access prices are assured and with passing a much-tempered competitive showing.

2. Prescriptive Approach

Under its prescriptive approach, the Commission contemplated a phased-in move to TSLRIC-based access rates in a more predictable and uniform manner than a market-based approach.[35] Importantly, the Commission acknowledged that its prescriptive approach would "require the Commission play a greater role in the telecommunications marketplace."[36] SWBT cannot support an even heavier regulatory hand, especially if that hand forces incumbent LECs to price access services at forward-looking cost with only a vague and temporary possibility of revenue shortfall recovery.

As the Commission pointed out, "the 1996 Act commands us to foster efficient competition in all telecommunications markets and to remove regulation when marketplace forces will drive competing providers to lower their costs and prices . . .."[37] The Commission's proposed prescriptive approach would certainly violate the deregulatory spirit of the 1996 Act alluded to here. Equally important, access rates prescribed at TSLRIC levels would not necessarily be a byproduct of freely competitive markets. Simply stated, a price is not a cost, even (and especially) in competitive markets. The demand side of the market must be considered. Finally, it comes as little consolation to SWBT that the Commission desires a somewhat gradual ratcheting down of prices to avoid "market disruptions" the might result from a flash-cut to TSLRIC levels. Unless the opportunity for

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[35]NPRM, paras. 218-219.
[36]NPRM, para. 218.
[37]NPRM, para. 220.

full and ongoing recovery of legitimate LEC actual costs is assured by the Commission, its prescriptive approach remains fatally flawed.

Only SWBT's approach to access restructuring through the outlined sequence of initial prescriptive-oriented price rebalancing and subsequent demand-responsive pricing flexibility overcomes the pitfalls of the Commission's proposed approaches and satisfies the 1996 Act's deregulatory and procompetitive pricing directives.

B. THE COMMISSION'S RULES SHOULD NOT SPECIFY A RATE STRUCTURE.

Currently, the Commission's rules specify the exact rate structure ILECs must follow in offering access services. This practice began with the original access charge plan when rate of return regulation was the norm and divestiture was the major event that had to be accommodated. The level of specificity has required ILECs to maintain a rate structure for special access which is distinct from switched access. However, the exact special access rate structure has never been defined below the category level in contrast to switched access which is typically specified down to the sub-element level. As a result, whenever ILECs attempted to offer a new switched access service that did not fit the rate structure specified in the rules a waiver had to be sought or a rulemaking had to be requested. This structural limitation has caused significant delays in the timely introduction of new services. The Third Report and Order in CC Docket No. 94-1, released with the NPRM in this docket, attempted to grant limited relief by establishing a new public interest standard in lieu of a waiver process when new switched services required new rate structures.

Specifying rate structures in the rules in any level of detail and requiring ILECs to request permission to vary from those structures is bound to continue to cause delays that the marketplace

will not tolerate. Quite simply, ILECs will be competitively disadvantaged, an outcome which was never intended by the pro-competitive aspects of the 1996 Act.

As companies, using new technologies and services, vie for customers, the likelihood that either the companies or the customers will all want the same structure is remote. The Commission's rules cannot and should not attempt to control the provision of service offerings in this manner. Specifying a rate structure for services that will utilize new technologies such as synchronous optical networks ("SONET"), Asynchronous Transfer Mode ("ATM") and advanced intelligent networks ("AIN") is undesirable from the viewpoint of fostering the fastest and most efficient penetration of these new technologies into the telecommunications infrastructure. Section 706 of the 1996 Act instructed the Commission to encourage the deployment of advanced telecommunications capability through methods that remove barriers to infrastructure investment.

The competitiveness of a market does not justify the need for specific rate structure rules. Competitive LECs have assurances of acquiring ILEC network elements as provided for by the 1996 Act and as specified in the Commission's rules. Codifying the unbundled network elements provides an adequate safeguard for competitors until they begin to utilize other facilities-based alternatives. The availability of a tariff in less competitive markets provides customers with the assurance that existing services will be available.

If the Commission decides to specify any rate structure in its rules, then such structure should be limited to designated public policy elements. These public policy elements should be designed in a manner that will not impact the provision of service to customers nor the ability of LECs to compete on equal footing in the marketplace.

C. COMPETITIVE MEASUREMENTS WILL ENSURE THAT COMPETITION IS WORKING.

In SWBT's serving area, some markets will be served by many providers; in others, consumers may have fewer choices. Since markets vary with regard to topography, size, mix of customers, density, income distribution, and other factors, regulation of these markets must be at least as diverse. SWBT proposes a system of decision points for the adoption of additional pricing flexibility for each of two market categories: the Open Market Category and the Effective Competition Category. Finally, services should be subject to forbearance when competitive pressure dictates certain market characteristics. SWBT discusses below the criteria that should be considered when determining eligibility for forbearance.

1. Open Market Category Trigger

The Open Market category is reached when Section 251-type interconnection agreements are reached[38] that contain either individually or collectively provisions for interconnection, unbundled elements, resale and collocation or when a state has approved a Statement of Terms and Conditions. The geographic areas over which relief is granted would match the areas covered by the interconnection agreement. In general, an agreement will encompass an individual state. The availability of resale, interconnection, access to unbundled network elements and collocation as provided for by Section 251(c). Meeting these requirements ensures that no unreasonable barriers to immediate market entry exist and guarantees the availability of alternate supply at least as vast as the incumbent LEC possesses. Since ubiquitous availability of alternate supply is now available to constrain LEC access prices, additional regulatory relief is warranted.

[38] Pursuant to Section 252

When open market conditions have been realized, SWBT proposes to streamline the price cap system as described elsewhere in our comments. LECs would also receive the flexibility to deaverage local switching, transport and other services whose costs vary by geography and/or density. Additional pricing flexibility would include volume and term discount, promotional pricing plans, contract pricing and the ability to respond to customer requests for proposal ("RFPs"). New service creation would occur outside of price caps. These changes would allow incumbent LECs to respond, in at least a limited way, to facilities-based competitors and others who use LEC unbundled network elements. These changes represent a very limited increase in LEC pricing flexibility, far less than possessed by LEC competitors.

2. Effective Competition Category Trigger

When competitive forces effectively constrain prices for a particular product in a geographic area, regulation of these prices no longer provides consumer benefits. In these situations, price regulation should be eliminated. In local markets, this threshold is effectively reached when competitors networks are operational and minutes are being exchanged. Therefore, SWBT proposes as a threshold, exchange of local minutes measured for the purposes of applying reciprocal compensation agreements. At this point, not only have barriers to entry been eliminated, but competitors are actually operating competing networks. These networks will effectively constrain incumbent LEC prices for access service warranting additional regulatory relief. Since LEC competitors will operate in local markets, the appropriate market area measurement is the area that is defined as local for purposes of applying reciprocal compensation. In addition to the Open Market Category flexibilities, services in effective competition areas will be removed from price caps. Filing intervals will also be reduced to one day's notice. No cost support will be required. However, incumbent LEC services will remain regulated under Title II and tariff filing will be

required pursuant to Section 203. The 208 complaint process will also ensure that remedy is available to address unlikely problems in the marketplace.

3. Forbearance

Forbearance from regulation of a service must occur when the three-pronged test of Section 10(a) of the Act is met: enforcement of a rule or regulation is not necessary to ensure that rates are just and reasonable and not unjustly or unreasonably discriminatory; enforcement of the rule or regulation is not necessary for protection of consumers, and forbearance is consistent with the public interest. Whether a market is sufficiently competitive to warrant forbearance can be determined through examination of a number of factors. Appendix 4 provides the justification for the forbearance of special access, direct trunked transport, directory assistance, operator services and interexchange services. However, as markets become more competitive, other services will qualify for forbearance. In general, in determining the appropriateness of forbearance for a particular service, the Commission should consider factors of demand responsiveness and supply responsiveness over a relevant geographic area. While market share can be examined, there are dangers in putting too much weight on market share alone. These factors are discussed in more detail below:

Demand Responsiveness. The Commission seeks comment on the proposal that a LEC need only provide evidence that comparable access services are available from other carriers and need not provide evidence specifically on demand responsiveness.[39] The formal quantification of demand responsiveness, such as econometric demand studies, are not necessary to a determination of the demand responsiveness of access services. This is because such studies are complex, costly to provide, and are not without problems. For example, the data required to perform a reliable

[39]NPRM at ¶156.

econometric measurement of demand responsiveness for access may not be available, and proxy data may have to be substituted, compromising the results. In addition, there is a dearth of studies of the demand responsiveness for access services.[40] Because telecommunications technologies are such that even a single entrant to the access market (or a small number of them) can provide capacity large enough to service a major proportion of a given access market area, it is best to assume that measurement of demand responsiveness be confined to evidence of availability of comparable access services.

When stripped to its essence, a competitive market is one in which consumers have alternative sources of supply, either actual or potential. Because it is possible for even a single entrant in an access market to handle a significant portion of the total market volume, questions of demand responsiveness be answered by amassing evidence that comparable access services are available from other carriers at comparable prices, and that more formal studies quantifying such demand responsiveness be avoided.

Supply Responsiveness. SWBT supports the Commission's tentative conclusion that the availability of unbundled network elements due to implementation of the 1996 Act decreases the cost of entry for access services. This is so even if the unbundled network elements are available at prices that exceed the so-called forward-looking economic cost. Thus, SWBT argues that the availability of unbundled network elements is presumptive evidence that there is a high supply elasticity in the access market.

Market Share. The Commission has posed the question of whether market share should be a factor in determining the level of competition for purposes of determining whether services should

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[40]A review of LESTER D. TAYLOR, TELECOMMUNICATIONS DEMAND IN THEORY AND PRACTICE (1994) indicates there are only a handful of publicly available studies of access demand.

be removed from price cap regulation.[41] SWBT generally agrees with the Commission when it contends that "we propose to consider market share in conjunction with other factors, including, but not necessarily limited to, supply and demand elasticities and pricing trends." SWBT does not oppose the Commission looking at market share data as long as the collection of the data is not burdensome or costly, and as long as the necessary data can be obtained from all providers. However, SWBT reiterates the Commission's opinion on the value of market share data[42] by pointing out that by itself, it cannot be used to measure market power, and hence the state of competition in a market.

Market power varies directly with market share; it varies inversely with the elasticity of the industry demand; and it varies inversely with supply elasticity.[43] Because of the effects of market supply elasticity and the price elasticity of demand, both of which are *inversely* related to market power, a "low" market share is indicative of a lack of market power, but a "high" market share does not necessarily indicate that market power exists, since high market shares can coexist with high price elasticities and supply elasticities, both of which serve to dampen market power. Thus, while low market shares can prove the absence of market power, high market shares alone do not allow a regulatory agency to make any reliable inferences.

Measuring Market Share. The way in which the Justice Department/Federal Trade Commission *Merger Guidelines*[44] propose that market shares be computed would be of value in the

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[41]NPRM at ¶158.

[42]NPRM at ¶203.

[43]These are discussed in William Landes & Richard Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937, 944-52 (1981); *and* E. THOMAS SULLIVAN & JEFFREY L. HARRISON, UNDERSTANDING ANTITRUST AND ITS ECONOMIC IMPLICATIONS 220-22 (1988). A good general discussion within a case study may be found in Albert L. Danielsen & David R. Kamerschen, *A Methodological Study of Market Power and Market Shares in Intrastate Inter-LATA Telecommunications, in* TELECOMMUNICATIONS IN THE POST-DIVESTITURE ERA 135, 147-49 (Albert L. Danielsen & David R. Kamerschen eds., 1986).

[44]U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines (Apr. 2, 1992), *reprinted in* 4 Trade Reg. Rep. (CCH) ¶ 13,104 [hereinafter Merger Guidelines].

Commission's future access reform proceedings. The *Merger Guidelines* suggest that "market shares be calculated using the best indicator of firms' future competitive significance."[45] This is important, for incumbent LECs may have high market shares (as a legacy of being the regulated sole provider in the past), yet due to competition, have no market power, even in the absence of regulation. Thus, market share calculations using shares of market capacity (if available) in lieu of shares of realized sales would be a far better way to compute market shares, if possible.

Market Share as a Trigger. The Commission has requested comment on whether a market share trigger could affect how a market develops. SWBT believes the Commission should *not* adopt a market share-based trigger. This is because market power is what's important as a measure of the competitiveness of a market, not market share; and a "high" market share in a regulated industry undergoing a transition to competition may mean nothing in terms of market power, since it may be but an artifact of the past, devoid of information concerning a regulated firm's actual ability to control current prices. This latter point has been made in the courts.[46]

Relevant Geographic Area. The Commission has requested comment on the relevant geographic area that should be considered in determining whether an incumbent LEC has met the Phase 2 competitive trigger. The Commission has tentatively concluded that any geographic area used in considering the presence of substantial competition would be appropriate for purposes of its Phase 2. SWBT agrees with this tentative conclusion, and points out that a relevant geographic area for market analysis need not conform to a state, a study area, or an urban/rural distinction. The way in which the Justice Department/Federal Trade Commission *Merger Guidelines* prescribe market

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[45]Merger Guidelines at 20,573-4.

[46]Metro Mobile CTS, Inc. v. New Vector Communications, Inc., 892 F.2d 62, 63 (9th Cir. 1989)("Reliance on statistical market share in cases involving regulated industries is at best a tricky enterprise and is downright folly where, as here, the predominant market share is the result of regulation. In such cases, the court should focus directly on the regulated firm's ability to control prices or exclude competition.").

definition, though difficult to follow to the letter, could provide more accurate guidelines for relevant geographic areas, and lead to more accurate analyses of the competitive nature of telecommunications markets.

According to the *Merger Guidelines*, all markets have two dimensions: a product dimension (*i.e.*, the products comprising the market, which are substitutes for one another), and a geographic dimension. Often, "markets" in regulation are arbitrarily defined so that the geographic dimension is the state, and the product dimension is assumed to be simply the product of interest. This is bound to lead to erroneous conclusions, ones which conclude that there is little or no competition, when in fact, in the relevant market, there *is*. SWBT assumes the Commission recognizes the danger of using a market definition that is geographically too large,[47] and encourages the Commission to avoid such pitfalls.

D. SWBT'S PROPOSED PRICE CAP BASKET STRUCTURE IS REASONABLE.

A new price cap basket structure is needed that reflects the current competitive environment and provides a flexible structure that is able to function effectively as the local exchange markets move toward full effective competition. SWBT proposes a price cap structure that is greatly streamlined yet contains consumer safeguards desirable in transitionally competitive markets.

The first step to achieving such a structure is to remove those services which are experiencing competition sufficient to warrant removal from price caps. As described in the forbearance section of our comments, special access, direct trunked transport, directory assistance, interexchange services and operator services all are experiencing levels of competition sufficient to

[47]NPRM at ¶155 ("We propose not to rely on a statewide analysis of competition.").

justify removal from price caps and tariff regulation. As such, SWBT proposes to remove each of these services from tariff regulation.

The second step toward redesigning price caps is to streamline the price cap structure. One of the fundamental design principles embodied in price caps is the grouping of services with similar functionality and competitiveness in a single basket or category. Segmentation in this manner allows the price cap mechanism to prevent "revenue shifting" from highly competitive services to services facing lower levels of competition. Consistent with this principle, SWBT proposes two baskets: Network Service and Public Policy.

The Network Service basket will contain four categories: transport and tandem switching, local switching, data base and subscriber line charge. The transport and tandem switching and the local switching category each would have a number of zones consistent with cost causation principles. Consistent with the 3rd Report and Order, each zone would have a +10 percent upper banding limit and no lower limit. This would allow LECs to flexibly reduce prices in a given zone but would limit offsetting price increases in other zones and categories. As no services exist in the categories that are not also contained in the zones, category banding limits would be redundant with the zone banding limits. As such, no category limits are proposed.

Due to the fact that LEC data bases effectively can serve all geographies from a single location, data bases by their nature do not have cost difference that vary with geography. As such, it is not necessary or appropriate to establish data base rates on a zone basis. Therefore, SWBT does not propose to establish zones for the data base category. Instead, a category upper banding limit of 10% is proposed.

SWBT does not propose to zone price SLC at this time. Consistent with this, only category constraints are proposed for the SLC category. SWBT proposes an upper banding limit of zero

percent. This would allow price decreases in the subscriber line charge but would only allow price increases relative to changes in inflation and the price cap index ("PCI"). This cap would prevent LECs from shifting any revenues from other services to the SLC while allowing appropriate increases consistent with changes in inflation. Appropriate downward flexibility is also allowed.

The Public Policy basket would contain four categories: common line, separations, transport and capital recovery. Each would contain public policy rate elements enacted for specific purposes as described elsewhere in our comments. Each public policy element is separated into its own category to enhance the ability to individually manage each element independent of other elements in the basket. Each category would have a zero upper banding limit. The upper band constraint would prevent any revenue shifting between public policy elements. Price reductions could be made at the LEC's discretion. Establishment of a separate Public Policy basket would also prevent revenue shifting to services in the Network Service basket.

The common line category proposed by SWBT would be a transitional element used to recover any residual CCL from interexchange carriers during a two-year transition period in which SLC would be increased on a common line-SLC revenue neutral basis. At the end of the two-year transition, the common line public policy element would be eliminated.

SWBT proposes to create separate Network Services and Public Policy baskets to allow the application of different productivity factors. SWBT proposes a productivity factor of zero in the Network Services basket and a productivity factor equal to the total factor productivity adjusted for productivity lost from a flat-rated public policy rate element structure in the public policy basket. Productivity factor development is discussed in Appendix 5. Separation into two baskets eliminates revenue shifting and allows the imposition of different productivity factors and exogenous changes.

IV. COMMON LINE STRUCTURE MUST BE BASED ON COST CAUSATION PRINCIPLES.[48]

A. COMMON LINE COSTS MUST BE RECOVERED FROM END USERS.

In the NPRM, the Commission acknowledged fundamental economic realities characterizing common line costs.[49] Common line costs are (1) non-traffic sensitive, and (2) "associated with the line connecting the *end user's* premises with the local switch . . ." (emphasis added). Thus the Commission accurately concluded that "[t]he current common line rate structure, in which only a portion of common line costs are recovered through [end user] flat monthly rates, does not reflect the manner in which loop costs are incurred."[50] More clearly, the Commission elsewhere acknowledged the vital economic reality that, contrary to the Joint Board's reticence, the current CCL charge represents a universal service support flow.[51]

Unfortunately, the Commission's suggested revisions[52] address only a portion of the structural problems. The changes contemplated by the Commission to recover non-traffic sensitive loop costs[53] through flat-rate charges to IXCs would perpetuate recovery of a substantial portion of loop costs from the wrong party, thus denying the economic reality that these costs are inextricably linked to end users and the network access provided to them by ILECs. The Commission seems

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[48]This section addresses NPRM Section III.B.

[49]NPRM, ¶¶ 57, 58.

[50]NPRM, ¶ 58.

[51]*See*, NPRM in CC Docket No. 96-45 (Universal Service), ¶ 113, where the Commission concludes: "[t]he current CCL charge appears to be inconsistent with the directives of the 1996 Act that universal service support flows be explicit. . . ." *See* also NPRM in CC Docket No. 95-72, ¶ 20, in which the Commission recognized that decreasing SLC increases CCL, which increases support flows, which could lead to inefficient bypass, which could undermine universal service.

[52]NPRM, ¶¶ 59-67. Where the Commission contemplates alternative CCL recovery through: flat rate charges to IXCs, bulk billing, capacity charges, trunk port and line port charges.

[53]NPRM, ¶¶ 60, 61.

willing to go only part of the way down the road to efficiency through flat-rate recovery of CCL charges.

ILECs are significantly different in their ability to recover total common line costs from end users. For example, NYNEX, USWest, BellAtlantic, and Ameritech recover approximately 60% of total common line costs from end user charges. Other ILECs, such as GTE, BellSouth, Pacific, and SWBT, recover approximately 40% of total common line costs from end user charges. Companies other than SWBT may not desire to shift common line cost recovery to an increased SLC to the extent that SWBT might choose. The Commission should permit sufficient flexibility to allow for those variances.

The Commission's starting point regarding common line cost and SLC restructure was where the Joint Board on universal service left off. In its Recommended Decision, the Joint Board acknowledged "the Commission must address the extent to which embedded loop costs should be recovered in its upcoming access charge reform proceeding."[54] At the same time, the Joint Board -- without economic or policy explanation -- failed to acknowledge the fact that CCL represents implicit support, and it dismissed the possibility of a SLC increase on primary residential and single business lines. If, however, the high cost fund size turns out to be insufficient for adequate recovery of incumbent LEC embedded common line costs, then the Joint Board's recommendation eliminates the most feasible and economically appropriate means of addressing common line cost underrecovery.

In the NPRM, the Commission did not address the Joint Board's failure to provide economic rationale for adopting its recommendation to freeze the single-line SLC cap. The Commission

[54]Federal-State Joint Board on Universal Service, Recommended Decision, CC Docket No. 96-45, released November 8, 1996, ¶ 771.

tacitly adopted the Joint Board's unfounded recommendation not to increase primary residential and single business line SLC caps (again, without economic explanation), but proposed to increase the cap on non-primary residential and multi-line business SLCs. The Commission pointed out that "[t]his would allow incumbent LECs to recover interstate common line costs for multi-line business customers and for residential connections beyond the primary residential connection in a manner consistent with the way costs are incurred."[55] It is, however, faulty logic to allow efficient recovery of common line costs from large business users and non-primary residential users, but to force continued -- and acknowledged -- inefficient and insufficient recovery from all other customers. Furthermore, it would be imprudent for LECs to elect to increase SLCs for competitively-vulnerable multiline business customers above their common line costs. Such action would make those customers more inclined to utilize alternative local providers. Moreover, even if LECs could increase SLCs for multiline customers above their cost, that action would exacerbate current implicit support flow from business to residential customers and from long distance to local users -- the very implicit support precluded by the 1996 Act. Finally, such an increase would continue the inefficient recovery of a substantial portion of common line costs, furthering the pitfalls (e.g., inefficient use of the network and uneconomic bypass) the Commission is seeking to correct.

The only corrective measure to end common line cost inefficiencies is for the Commission to respond by eliminating the CCL and shifting recovery so that loop costs are recovered through increases to the primary single-line SLC. There need be only one uniform SLC, the same for residence, single- and multiline business subscribers. Underlying loop costs do not vary by customer class, therefore SWBT requests removal of customer class distinctions applied to SLCs.

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[55]NPRM, ¶ 65.

The only reason the Commission should deny a SLC increase would be if it finds the increase to be unaffordable for end users. SWBT documented in the universal service proceeding that the gradual elimination of the interstate CCL charge and the phased-in shift of its recovery to end users will lead to substantial economic gains for consumers as access price reductions generate toll reductions.[56] Perceived adverse impacts of SLC increases on telephone subscribership levels seem even more remote when coupled with the federal-state Joint Board's recommendations to enhance assistance for lower income participants in the Lifeline program.[57] The Joint Board recommendation was to increase the federal Lifeline benefit from $3.50 to a maximum of $7.00. A federal Lifeline benefit of $7.00 would more than offset Lifeline customers' potential bill increases associated with SWBT's proposal to raise the SLC by $1.30 and to institute a $0.35 port charge.

The proposed $1.30 increase in the SLC, along with the proposed $0.35 switching port charge, would increase the average SWBT residence customer's total state and interstate billing for basic flat rate local exchange service from $14.28 to $15.88. SWBT's proposal would eliminate continued reliance on interexchange carriers for common line cost recovery. There is simply no compelling reason for the Commission to be reluctant to allow ILECs the flexibility to eliminate the CCL and to phase in a SLC increase for residential and single-line business lines.

B. THE COMMON LINE PUBLIC POLICY ELEMENT SHOULD PROVIDE RECOVERY UNTIL COMPLETION OF A TRANSITION.

As explained above, the SLC transition will take approximately two years to complete. At the beginning of the transition, CCL costs will be reduced to account for the recovery of LTS from the new federal universal service fund and the removal of payphone costs. After these changes, a

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[56]Southwestern Bell Telephone Comments in CC Docket No. 96-45, filed April 12, 1996, pp. 5-6.

[57]Federal-State Joint Board on Universal Service, *Recommended Decision*, CC Docket No. 96-45, released Nov. 8. 1996, para. 771.

common line residual will continue to exist because common line costs are not recovered by the application of a $3.50 SLC to residence and single-line business customers.

As SWBT described in Section II above, this residual should be explicitly recovered with a new federal universal service fund surcharge. If this recovery does not occur, then a common line public policy element will be required to recover residual interstate common line costs. This new element should be a flat rate monthly charge because it will be used to recover interstate loop costs which are incurred on a non-traffic sensitive basis. Flat rated recovery is more economically efficient because a minute of use mechanism would require high volume customers to assume a greater responsibility for cost recovery even though their service did not cause additional costs for SWBT.

The common line public policy element would be billed to IXCs on a presubscribed line basis. Additionally, the common line public policy element would be billed to carriers that purchase unbundled loops on a per-loop basis, if the Commission limits SWBT's ability to apply the full SLC. This allocator is reasonable in that it is directly linked to the line which is the type of cost that is being recovered. If an end user has not designated a presubscribed carrier, then the common line public policy element should be billed to the end user. Due to the shortness of this transition period, it is not necessary to deal with IXCs that are used by end users on a casual calling basis. As the SLC increases, the common line public policy element would decrease. At the end of the two-year period, the common line public policy element would be eliminated.

V. ACCESS STRUCTURE MUST PROVIDE THE OPPORTUNITY FOR INCUMBENT LECS TO RECOVER ACTUAL INTERSTATE COSTS.[58]

A. REGULATORS HAVE PREVIOUSLY DETERMINED THAT THE INCUMBENT LECS' ACTUAL COSTS REPRESENTED PRUDENT COSTS, AND IT IS UNTENABLE TO REQUIRE INCUMBENT LECS TO PRODUCE FURTHER SHOWINGS OF PRUDENCE AND REASONABLENESS.

The efficiency of LEC operations must be reviewed in light of the regulatory social contract under which the LECs operate. The prudency of LEC costs incurred to meet these unique public service obligations has already been proven. The collective existing costs reflect regulatory policies and mandates for the industry to 1) provide network capacity for all U.S. residents, and 2) establish the most reliable network while meeting high service standards.

1. Existing Costs Reflect Regulatory Policies and Mandates for the Industry.

a. Obligations to Serve

LEC actual costs reflect the cost of historical regulatory policies and industry mandates. Incumbent LECs have the unique public service obligation as carrier of last resort to provide universal telecommunications service to any and all customers who request it. In general, state commissions have required LECs to serve all customers requesting service within service franchise areas, regardless of the costs of serving any individual customer.

b. Network Reliability and Service Standards

Many states have rigorous standards for quality of service that must be met by the LEC. For example, Missouri law sets out specific service objectives, such as:

1) 97% of calls receive dial tone within three seconds;

[58]This section addresses NPRM Sections IV.B; V.B; VII.B.

2) 97% of properly dialed direct distance calls shall be completed without encountering blockage;

3) 90% of repair service and business office calls shall be answered within 20 seconds or equivalent index;

4) 90% of regular service order installations shall be completed within five working days from receipt of the application.

The LECs must ensure that adequate facilities and personnel are available to meet the service quality objectives and maintain an acceptable quality of service at all times. LECs are required to submit periodic monitoring reports regarding their performance in meeting each of these standards.

c. Deferred Regulatory Recognition of Certain Costs

Commission rules and procedures regarding depreciation lives and net salvage amounts determine whether capital costs will be adequately reflected in the cost of service and over what period of time. As described earlier, excessively long prescribed depreciation lives result in a postponement of recovery of prudent capital investments that legitimately belong to shareholders. Regulation has resulted in the deferral of capital recovery into future periods beyond the economic life of the assets invested in by LECs in order to reduce the impact on customer rates. To the extent that this has occurred, LECs have been unable to recover these investment costs.

d. Administrative Costs of Regulation

Included in the LECs' actual costs are those required to meet numerous and detailed regulatory accounting requirements. Each year LECs submit hundreds of thousands of pages of paper reports, including income statements, balance sheets, cash flow statements, capital investment reports, tariffs and their support documents, cost reports, demand reports, cost allocation manuals, separations reports, affiliate transaction documentation, service quality

reports, infrastructure development reports, nondiscriminatory access reports, projections of expected network demand and usage, and much more. In addition, LEC administrative costs include the expenses associated with Commission audits and reviews, as well as external audits of LEC systems required by Commission rules. Each of these regulatory requirements necessitates a level of investment, personnel and administrative expense by the LEC in order to fully comply.

2. LEC Costs Have Been Scrutinized.

LEC expenditures, both capital and expense, have been under the scrutiny of both federal and state commissions.

Federal

Commission rules define what is included in the cost of service used as a basis for current access charges. Through these rules, the FCC has, in essence, defined what it considers to be legitimate costs recoverable from interstate rate payers. While LECs' interstate operations were regulated using cost-based regulation, the Commission continually modified and upgraded its regulatory tools to determine the prudency of the costs incurred by LECs on behalf of customers.[59] In doing so, the Commission noted that "rate of return oversight is a responsible, functional method of correcting for [the inclusion of unnecessary costs]."[60] The FCC has pointed to its previous prudency determinations, stating in 1990 that "the Common Carrier Bureau has disallowed over $2.7 billion in LEC access charges since 1985." [61] For example, in its review of

[59]In the LEC Price Cap Order, the FCC made the following conclusions: "Extensive attention is placed on costs." "A major part of the cost allocation process is dictated by our regulatory requirements. Para. 24. "Our lengthy, substantial, and ongoing efforts to improve our rate of return methods, however, cannot create the positive incentives that are embodied in incentive-based regulation." Para. 25.

[60]LEC Price Cap Order, Para. 29.

[61]LEC Price Cap Order, footnote 31.